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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

25 February 1983

Indonesia: Worsening Economic Prospects [redacted] 25X1

Indonesia's financial position has deteriorated since we examined the economy in [redacted] 25X1 1982. That assessment projected a $7-8 billion current 25X1 account deficit and predicted that, barring signs of downside slippage, Indonesia would be able to cover its deficit for 1983 25X1 without having to resort to unacceptably stiff domestic austerity measures. The likelihood of a decline or, possibly, downward spiral in nominal oil prices, the continuing soft market for non-energy raw materials; and a below average rice crop expected this year have in our judgment caused a deterioration in prospects and raise questions about how long financiers will continue to provide funds to the government without strong remedial action by Jakarta. Under the most optimistic scenario, Indonesia will have a large current account deficit to cover in 1983; should oil prices tumble, the government would be forced to adopt more stringent and politically difficult austerity measures. [redacted] 25X1

The weak oil market is pushing down both volumes and prices of Indonesia's crude oil exports while foreign demand for its traditional nonoil exports remains soft.

-- Crude oil output fell below 1.1 million b/d in January, 500,000 b/d below capacity, and 200,000 b/d below Indonesia's OPEC quota. Each 100,000 b/d drop in exports costs Indonesia over $1.2 billion in annual revenue at current prices.

This memorandum was prepared by [redacted] *Malaysia, Singapore, Islands Branch, Southeast Asis Division, Office of East Asian Analysis of the Directorate of Intelligence. It was coordinated within the Directorate of Intelligence and the National Intelligence Council. Information available as of 24 February was used in its preparation. Comments are welcome and may be directed to the Chief, Southeast Asis Division* [redacted] 25X1

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[redacted] 25X1

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-- It now appears that nominal oil prices will at a minimum fall by $3 to $4 per barrel, causing foreign exchange earnings from LNG, Indonesia's second largest export commodity, to fall in line with crude oil price cuts. Each $1 drop in oil prices at 1982 export levels reduces combined oil and gas export revenues by some $350 million annually.

-- Recovery in exports of wood, rubber, coffee, tin, palm oil and other traditional agricultural and mineral products has not yet materialized and appears likely to lag the economic recovery of major markets in the United States, Japan, and Western Europe. 25X1

Without a dramatic improvement in export performance or a drastic shift in import policy, we now estimate the current account deficit in 1983 will fall in the $9-11 billion range compared to an estimated $7.4 billion last year and could be even higher if oil prices spiral downward. This estimate includes a projected 5 percent increase in import volume in 1983 based on spending plans already in place. 25X1

Even under what now appears to be a best case, Indonesia's current account deficit will increase in 1983, forcing the government to adopt tougher austerity measures later this year. However, we cannot rule out a downward spiral in oil prices. In this event, Jakarta would have to take drastic action on imports to keep the deficit within bounds. Such action would lead to a sharp increase in domestic inflation, a decline in living standards, and a further slowdown in the country's economic growth rate. 25X1

Despite prospects for a sizable current account deficit, Jakarta is pressing ahead with most major industrial development programs. An austerity program introduced this year does reduce subsidies for fuel, food, and fertilizers, freezes civil servant and military wages, and cuts back on other current outlays. 25X1

Given current policies, we believe Jakarta's likely import performance offers little promise of financial relief in 1983. Capital and intermediate goods needed largely to fuel the development program account for nearly 90 percent of imports and consumer goods for only about 10 percent. Even if the government should risk economic dislocations by freezing imports, a lengthy drought in 1982 delayed planting of this year's major rice crop and could cut the 1983 rice harvest by 10 percent. In this event, Jakarta could be forced into the international market for 1.5-2.0 million tons of rice, a level equivalent to the late 1970s when Indonesia was the world's largest rice importer. 25X1

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On the financial front, Jakarta is moving to line up increased foreign borrowing. In 1982, Indonesia's strong financial position and the widespread belief that the world oil glut would be temporary enabled it to finance the current account deficit through a combination of borrowing abroad and drawing down reserves. This year, we believe Jakarta will be very reluctant to draw down official reserves sharply below the current level of about $4 billion. The government has access to about $4 billion of net foreign assets accumulated by the state banks over the past few years and Bank Indonesia officials are arranging a $1 billion syndicated loan, which will be the second largest commercial credit ever obtained by an Asian borrower. The Indonesians are finding it necessary, however, to pay a higher interest rate than previously and are displaying growing nervousness over the availability of funds. Press reports indicate Indonesia is considering asking the IMF for $600 million in financial assistance to help compensate for the fall in its export prices. [redacted] 25X1

Although international bankers as a group remain bullish on Indonesia, [redacted] many are becoming increasingly nervous over their exposure. Any further weakening in Jakarta's external accounts, or even a failure to show signs of improvement, could intensify bankers' fears and sharply reduce the availability of funds. This, in turn, would force Jakarta to deal with additional politically difficult spending cutbacks. [redacted] 25X1

Indonesia's poor export performance and the government's austerity program so far have not led to serious civil disturbances. Nonetheless, sharper inflation resulting from cuts in consumer subsidies, scattered food shortages, and growing unemployment are intensifying the already severe pressure on Indonesia's poor. In the past, price hikes and shortages of consumer goods have sparked urban rioting. [redacted] 25X1

The government is carefully monitoring the political opposition and potentially disruptive groups such as unemployed youth, students, labor, and Muslims. Security officials are on the alert to suppress any threat to disrupt the 1-11 March session of the People's Consultative Assembly (MPR), which is meeting to reelect President Soeharto to another five year term, and to approve his choice for Vice President and the regime's political guidelines for the next five years. The highlight of the session is to be the designation of Soeharto as Indonesia's "Father of Development." [redacted] 25X1

Although opposition to the regime has been muted, there seems little doubt that disaffection is growing. Indeed, some observers see growing disaffection even among Soeharto's loyalists in the bureaucracy because of the government wage freeze and an incease in corruption by officials to make up for the loss in real income caused by the freeze -- a development that would further alienate Indonesia's have-nots. The possibility of anti-Chinese riots sparked by some minor incident is always present, and the current economic situation increases the danger that such riots could quickly develop an anti-Soeharto or antigovernment character. 25X1

Indonesia: Current Account Scenarios, 1983[1]

		Crude Oil Exports (1,000 b/d)			
		1,100	1,000	875[2]	775
		Current Account Balance (Billion US dollars)			
	$33.60[2]	-6.2	-7.4	-9.0	-10.2
PRICE PER BARREL	$30.00[3]	-7.4	-8.5	-10.0	-11.1
	$27.00[3]	-9.0	-10.0	-11.3	-12.3
	$25.00[3]	-10.0	-11.0	-12.1	-13.1
	$20.00[3]	-12.5	-13.3	-14.2	-15.0

[1]Projections assume: 1) 5 percent real growth in imports in 1983. Each 1 percent reduction in imports would cut the current account deficit by $200 million; 2) nonoil exports are assumed to grow at 5 percent with no adjustment made for faster world economic growth caused by lower oil prices.

[2]Indonesia's average price and volume for 1982.

[3]OPEC average prices.

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Indonesia: Change in Real Imports that Would Hold

1983 Current Account Deficit to $8 Billion[1]

		Crude Oil Exports (1,000 b/d)			
		1,100	1,000	875[2]	775
PRICE PER BARREL	$33.60[2]	+14 %	+ 8 %	0 %	- 6 %
	$30.00[3]	+ 8 %	+ 3 %	- 5 %	-10 %
	$27.00[3]	0 %	- 5 %	-12 %	-16 %
	$25.00[3]	- 5 %	-10 %	-16 %	-20 %
	$20.00[3]	-18 %	-22 %	-26 %	-30 %

[1]These projections assume a 5 percent real increase in nonoil exports with no adjustment made for faster world economic growth caused by lower oil prices.

[2]Indonesia's average price and volume for 1982.

[3]OPEC average prices.

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SUBJECT: Indonesia: Worsening Economic Prospects [redacted] 25X1

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Note: 1 Copy hand carried to Armitage on Thursday, Feb. 24, 1983

OEA/SEA/MSI [redacted] (28 February 1983) 25X1

NOTE:

Short note sent out to people at Department of State, Department of Commerce, Department of Energy, Department of Treasury, and NSC.

Office of East Asian Analysis
DIRECTORATE OF INTELLIGENCE

NOTE FOR: The Honorable Paul Wolfowitz
The Assistant Secretary for
East Asian and Pacific Affairs
Department of State

Paul,

The attached memorandum briefly outlines our growing concerns over Indonesia's financial prospects. The possibility of a decline in oil prices and failure of other raw material prices to stage a comeback have put Indonesia in a difficult financial position. While the international financial community still considers Indonesia one of Asia's better credit risks, the situation is deteriorating and should be watched closely.

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Director

Attachment:
As stated above